73-SBE-036

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CITIZENS DEVELOPMENT CORPORATION)

For Appellant: Stanton H. Zarrow
Attorney at Law

For Respondent: Crawford H. Thomas
Chief Counsel

Marvin J. Halpern
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Citizens Development Corporation against a proposed assessment of additional franchise tax in the amount of $104,591.77 for the income year ended June 30, 1968.

Appellant is a land developer. In June 1968 appellant found itself in financial difficulty and was unable to meet its current mortgage payments. In order to avoid bankruptcy appellant entered into an agreement

with its chief creditor. The agreement provided that appellant would transfer to the creditor a fee simple interest in all its vacant and unimproved land, as well as one-half interest in all its developments and improvements. In exchange for the property interests transferred the creditor agreed to reduce appellant's indebtedness by $5,402,835.94. Under the terms of the agreement appellant continued to operate the improvements and to proceed with its developments. Appellant treated the transfer as nontaxable and made a surplus adjustment for the actual gain involved.

Upon audit of appellant's return for the income year ended June 30, 1968, respondent determined that appellant's transfer of the property was, in fact, a taxable transaction and increased appellant's taxable income by $1,494,168.08 which represented the gain on the exchange. In calculating the gain resulting from the transfer respondent determined that the basis of the property was $3,908,667.86. In computing the basis of the property transferred, respondent refused to include carrying charges totaling $1,148,710.42 which appellant originally deducted in previous years but elected to capitalize on amended returns filed September 15, 1968.

Appellant protested. the proposed deficiency but the protest was denied. Appellant. then filed this appeal, conceding that the transfer was taxable but challenging respondent's refusal to recognize as part of appellant's basis the carrying charges it elected to capitalize on its amended returns.

Section 24421 of the Revenue and Taxation Code provides that ".. .no deduction shall be allowed for the items specified. in this article." One of the items specified as nondeductible is describe-d in section 24426 as:

> Amounts paid or accrued for such taxes and carrying charges as, under regulations prescribed by the Franchise Tax Board: are chargeable to capital account with respect to property, if the taxpayer elects, in accordance with such regulations, to treat such taxes or charges as so chargeable. (Emphasis added.)

This provision is substantially identical to section 266 of the Internal Revenue Code of 1954.

In accordance with the statute the Franchise Tax Board has prescribed regulations controlling the method whereby the taxpayer must exercise his election. The regulations provide:

> If the taxpayer elects to capitalize an item or items under this regulation, such election shall be exercised by filing with the original return for the year for which the election is made a statement indicating the item or items (whether with respect to the same project or to different projects) which the taxpayer elects to treat as chargeable to capital account .... (Emphasis added.) (Cal. Admin. Code, tit. 18, reg. 24-426(a), subd. (3)(C).)

This regulation is substantially identical to its federal counterpart, Treasury Regulation section 1.266-1(c)(3).

Respondent contends that its regulation is specific in requiring that the election to capitalize carrying charges be exercised with the original return. Therefore, appellant's attempted election to capitalize such charges by amended returns was untimely and cannot be given effect. Appellant, although acknowledging the clear and unequivocal language of the statute and regulation, asserts that there is no case which specifically holds that the election in question cannot be made on an amended return. in support of its position

appellant relies on four federal cases dealing with taxpayers who chose to report, in amended returns, sales of realty or casual sales of personalty pursuant to the installment sales provisions of Internal Revenue Code section 453(b). (See Hornberger v. Commissioner; 289 F.2d 602; Lipman's Estate v. United States, 245 F. Supp. 393; Jolley v. United States, 246 F. Supp. 533; Stouffer v. United States, 225 F. Supp. 965.) However, the federal regulation interpreting that section does not specifically require that the election be made on the original return; Since the regulation with which we are concerned does specify that the election be made on the original return appellant's authorities are not persuasive.

Contrary to appellant's assertion that no case has held that the election to capitalize carrying charges must be made on the original return there is a line of federal cases interpreting the federal counterpart to the California regulation which have so held. (See, e.g., Kentucky Utilities Co. v. Glenn, 394 F.2d 631; Oklahoma Gas & Electric Co. v. United States, 289 F. Supp. 98; Estate of George Stamos, 55 T.C. 468; cf. Rev. Rul. 70-539, 1970-2 Cum. Bull. 70.)

In Kentucky Utilities Co. v. Glenn, supra, the taxpayer, on its original return, deducted certain taxes while listing the amount of social security taxes not deducted. Thereafter, in an attempt to deduct the social security taxes, the taxpayer relied upon the fact that no formal statement of election to capitalize was ever made. They filed amended returns within the time limits allowed by statute along with statements electing to deduct the social security taxes as expenses. The court held that the taxpayer, which failed to file a formal statement of election to capitalize the social security taxes with its original return, did not retain the right to make a subsequent election by filing a formal statement with an amended return. In so holding the court asserted that in exercising the option granted by the regulation the taxpayer must do so by filing with the original return a statement for that year listing the items he wishes to capitalize. The court stated that the language of the regulation was designed to prohibit

the withholding of any statement so as to permit the later exercise of the option. (Kentucky Utilities Co. v. Glenn, supra at 634; cf. Rev. Rul. 70-539, 1970-2 Cum. Bull. 70.)

Similarly, in the Oklahoma Gas & Electric Co. case the court found "that because of the taxpayer's failure to formally elect to capitalize State sales and use taxes in 1954, 1955 and 1956, it was precluded from capitalizing them and was required to deduct them as expenses in each year." (Oklahoma Gas & Electric Co. v. United States, supra at 101.)

Kere appellant deducted the charges in question on its original returns -and, of course, did not file statements indicating its election to capitalize such charges, Such omission was fatal. Appellant cannot now change its position by electing to capitalize carrying charges by amended returns. Therefore, we conclude that where a tax-payer fails to file the required statement of election to capitalize appropriate carrying charges with its original return for the year in which the election is made it is precluded from electing to capitalize such charges by amended return in a later year. Accordingly, respondent's action in this matter must be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protestof Citizens Development Corporation against a proposed assessment of additional franchise tax in the amount of $104,591.77 for the income year ended June 30, 1968, be and the same is hereby-sustained.

Done at Sacramento, California, this 31st day of July, 1973, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary